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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-144851-07
Date: February 4, 2008

Legend:

$$\underline{X} =$$
Y =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Year 1 =

Year 2 =

Dear _____ :

This letter is in response to your request, dated September 27, 2007, on behalf of X, seeking inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

Facts

Based on the materials submitted and representations within, we understand the relevant facts to be as follows. X was incorporated in Year 1 in accordance with the laws of State. X made an election to be treated as an S corporation effective Date 1. On Date 2, X amended its articles of incorporation to include both for the designation of Class A and Class B stock and the inclusion of disproportionate distribution language with respect to the stock. By its terms, the amended articles stated that the two classes of stock would be identical in all terms, with the exception of voting rights. On Date 3, Y, along with other subchapter S corporations, merged into X, leaving X as the surviving corporation, with Class A and Class B shares outstanding. At the time of the merger, X's articles of incorporation included disproportionate distribution language.

X determined that due to the issuance of Class A and B stock to its shareholders in Year 2 and the specific terms of the articles of incorporation entered into, X may have inadvertently created a second class of stock in violation of the one class of stock requirement in section 1361(b)(1)(D). On Date 4, amended articles were filed to delete the disproportionate distribution language. On Date 5, Articles of Correction were filed to explain the conversion of the Class B shares to Class A shares at the time of merger.

X represents that it did not intend to create a second class of stock. As soon as X realized the problem, X under took steps to correct the problem. X represents that it already has amended the current articles to alleviate any possible problems. The amended articles deleted the disproportionate distribution language. X and its shareholders represent that all allocations of income, losses, deductions and credits for X were made on a pro rata basis among all the shareholders of both classes of stock as though all shares were one class of stock for all years at issue. In addition, no disproportionate distributions were made for all years at issue.

Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under section 1362(a) is in effect for the year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the "governing provisions"). A commercial contractual agreement, such as a lease, employment agreement, or loan agreement, is not a binding agreement relating to distribution and liquidation proceeds and thus is not a governing provision unless a principal purpose of the agreement is to circumvent the one class of stock requirement. Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1.1361-1(l)(2)(iii)(B) provides that bona fide agreements to redeem or purchase stock at the time of death, divorce, disability, or termination of employment are disregarded in determining whether a corporation's shares of stock confer identical rights.

Section 1362(d)(2)(A) provides that an election under section 1362(a) will be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under section 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to section 1362(b)(2)) by reason of a failure to meet the requirements of section 1361(b) or to obtain shareholder consents, or (B) was terminated under section 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to section 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based on the information submitted and the representations made, we conclude that X's S corporation election may have terminated because X may have had more than one class of stock. However, we conclude that, if X's S election was terminated, such a termination was inadvertent within the meaning of § 1362(f) of the Code. Further, we conclude that the corrective action taken by X and its shareholders does not create a second class of stock under section 1361. Consequently, we rule that X will be treated as continuing to be an S corporation from Date 1, and thereafter, provided that X's S election otherwise is not terminated under § 1362(d).

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the facts described above under any other provision of the code. In particular, no opinion is expressed or implied as to whether X otherwise qualifies as a subchapter S corporations under § 1361.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and are accompanied by a perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of this request, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter ruling will be sent to the taxpayer representatives.

Sincerely,

/s/

David Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy for section 6110 purposes
Copy of this letter